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IN THE

Supreme Court of the United States

OCTOBER TERM, 1944

No. 1372 126

AVIATION CAPITAL, INCORPORATED
(In Liquidation),

Petitioner,

against

WILLIAM J. PEDRICK, Collector of Internal Revenue,
Second District of New York.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF

FRANCIS H. HORAN
Counsel for Petitioner
Aviation Capital, Incorporated
(In Liquidation)

WEBSTER & GARSIDE
FREDERICK SHEFFIELD
HENRY CASSORTE SMITH
Of Counsel

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner prays that a writ of certiorari be issued to review a judgment of the Circuit Court of Appeals for the Second Circuit (R. 116) affirming a judgment of the District Court of the United States for the Southern District of New York (R. 100) dismissing the petitioner's complaint in an action for the refund of alleged income tax deficiencies for the calendar years 1937, 1938 and 1939, paid under protest by the petitioner.

Opinions Below

The opinion of the Circuit Court of Appeals, not yet reported, is printed at R. 109. The opinion of the District Court is reported in 56 F. Supp. 964.

Jurisdiction

The judgment of the Circuit Court of Appeals was entered March 13, 1945. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code as amended by Act of Feb. 13, 1925 (28 U. S. C. Sec. 347-a).

Questions Presented

(1) Whether an investment corporation derived taxable income from the resale of its own stock repurchased from stockholders, where:

(a) the charter required such repurchase on request;

(b) mandatory repurchase was a necessary attribute of the stock in order to attract investors;

(c) the repurchase price was fixed by the charter at current liquidation value;

(d) stock was repurchased only when stockholders so demanded;

(e) the resale of the stock was for the purpose of raising much needed capital;

(f) the resale price was always the liquidation value of the stock at the time of resale; and

(g) the purchases and resales were not made pursuant to a plan to make a profit.

(2) Whether Article 22(a)-16 of Regulations 94 and 101 respectively is invalid because its predecessor regulation had been adopted by Congress and was so imbedded in the law as to be alterable only by legislation.

(3) Whether Article 22(a)-16 of the Regulations, here held to reach capital transactions, is valid under Section 22(a) of the Revenue Acts of 1936 and 1938; and

(4) If Article 22(a)-16 of the Regulations is supported by Section 22(a) of the statute, can the latter constitutionally thus reach transactions to raise capital?

Statutes and Regulations Involved

Section 22(a) of the Revenue Act of 1936 (26 U. S. C. A. 22) and Section 22(a) of the Revenue Act of 1938 (26 U. S. C. A. 22) are identical and read as follows:

"§ 22. GROSS INCOME

(*a*) *General definition.* 'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. In the case of Presidents of the United States and judges of courts of the United States taking office after June 6, 1932, the compensation received as such shall be included in gross income; and all Acts fixing the compensation of such Presidents and judges are hereby amended accordingly. In the case of judges of courts of the United States who took office on or before June 6, 1932, the compensation received as such shall be included in gross income.

"(*b*) * * *"

Regulations 94, Art. 22(a)-16 and Regulations 101, Art. 22(a)-16 are identical and read as follows:

"*Acquisition or disposition by a corporation of its own capital stock.*—Whether the acquisition or disposition by a corporation of shares of its own capital stock

gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

"But if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Act."

Statement of Facts

The facts as found by the District Court (R. 92-97) may be summarized as follows:

The taxpayer, a Delaware corporation now dissolved,* was engaged in the business of purchasing, holding, selling and dealing in the securities of aviation companies (R. 92-93). Its charter required it, upon demand, to repurchase its own capital stock at the current liquidation value of its assets (R. 93).

From 1929 to 1939 the taxpayer, always upon demand and pursuant to the above charter provisions, purchased shares of its own stock which it thereafter held in its

* Under the Delaware statutes the taxpayer, although dissolved, continued its corporate existence for the purpose of prosecuting and defending suits and of enabling it to settle and liquidate its affairs (R. 92).

treasury instead of retiring it (R. 93). In 1937, 1938 and 1939 it resold this treasury stock at current liquidation value, which was a higher aggregate amount than it had paid for the stock (R. 94). The treasury stock was resold to obtain much needed additional working capital (R. 95). In each of the years 1937, 1938 and 1939 the taxpayer had available authorized but unissued capital stock which it could have sold in lieu of its treasury stock (R. 95). (If it had sold its authorized but previously unissued stock the very regulations here held applicable provide that no tax be imposed.)

Upon the issue of its stock the taxpayer regularly allocated the sales price thereof in excess of par value to paid-in surplus (R. 94). Upon the purchase of its own stock appellant charged paid-in surplus with the purchase price in excess of par value (R. 94).

The taxpayer in purchasing its own stock handled the transaction on its books differently from the way it handled the purchase of stock of other corporations. In the purchase of other stocks there was no change in the company's net worth, but merely a change in form of assets, from dollars to investments. In the purchase of its own stock there was a reduction of the company's net worth in that the stock so purchased was not carried as an asset or as having any value, although it was not canceled or retired. The company paid itself no dividends on such treasury stock. When the company sold its own stock so acquired, the excess of the proceeds over its par value went to surplus account, increasing the company's net worth. In the sale of other stocks the profit or loss therefrom went into income account. The sale of the treasury stock had the same effect on the books of the company as if unissued stock had been sold (R. 95).

The Commissioner of Internal Revenue, on review and audit of the returns for 1937, 1938 and 1939, determined alleged deficiencies (including interest) for these years of $11,415.36, $10,916.67 and $23,959.36 (R. 95).. These alleged

deficiencies were based upon the difference between the aggregate price at which the taxpayer had reacquired its stock and the aggregate price at which it had subsequently resold the stock (R. 95). After the taxpayer had duly filed protests it paid the alleged tax deficiencies on October 9, 1942 and filed claims for refund on December 3, 1942 (R. 61). This suit for a refund was instituted on September 23, 1943 (R. 9), more than six months having elapsed without action having been taken by the Commissioner in respect of the claims for refund (R. 96).

The District Court, after a trial without a jury, held that taxable gain resulted from the transactions described and judgment was entered for the Collector.

Reasons for Granting the Writ

1. The decision below brings to a head a vexed situation that has been building up since 1934 when the Commissioner of Internal Revenue abandoned his seasoned regulation that a corporation did not derive taxable gain from transactions in its own stock. Having adopted a new regulation, still in effect, that taxable gain could result from such transactions, the Commissioner began to stretch its meaning to cover every sort of transaction in "treasury stock". The lower courts have supported him to the point that one of the concurring Circuit judges characterized this decision as a "singular triumph of form over substance" (R. 115). The regulation now means anything that the Commissioner of Internal Revenue says it means, despite its express provisions that whether such transactions are taxable "depends upon the real nature of the transaction" and whether the corporation is dealing with its own shares in the same manner as though it were dealing in the shares of another. Although of interest to every corporation the question is of prime importance to investment corporations.

The important general question involved—whether a corporation can derive income from the sale of its own stock—has not been passed upon by this Court. For nearly thirty years the Treasury and the lower courts have drifted hither and yon in this important field of taxation. The present state of the law stultifies accepted principles of corporate accounting. The lower courts are evolving curious concepts of corporate income. The confused situation calls for review by this Court.

2. The validity of an important current regulation is in issue. In *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U. S. 110 (1939), at p. 116, this Court explicitly left open the question whether the predecessor regulation was so imbedded in the law as to require legislative alteration, if alteration was wanted. This unsettled question, anticipated by the Court, is now here and this Court should pass upon it because of its very important bearing on administrative law.

3. As interpreted and administered by the Bureau of Internal Revenue, the regulation here involved is in direct conflict with the rules of the Securities and Exchange Commission in respect of the treatment of proceeds from sale of treasury stock.

CONCLUSION

For the reasons stated the writ should be allowed.

Respectfully submitted,

FRANCIS H. HORAN
Counsel for Aviation Capital, Incorporated (In Liquidation)

WEBSTER & GARSIDE
FREDERICK SHEFFIELD
HENRY CASSORTE SMITH
Of Counsel